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In the Supreme Court of the United States

October Term, 1927

No. 311

BOTANY WORSTED MILLS, PETITIONER

v.

THE UNITED STATES

On Writ of Certiorari to the Court of Claims

BRIEF AMICUS CURIAE

CONWAY-SCOTT COMPANY, LAW PRINTERS, DETROIT, MICH.

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In the Supreme Court of the United States

October Term, 1927

No. 659

BOTANY WORSTED MILLS, PETITIONER

v.

THE UNITED STATES

On Writ of Certiorari to the Court of Claims

BRIEF AMICUS CURIAE

The Questions Presented

The question presented is whether in a case where various disputed tax matters for the year 1917 (which involved the questions of the reasonableness of compensation paid to directors, the amount of depreciation on buildings and machinery to be charged off, and the propriety of certain deductions for reserves charged to expenses, the determination of each of which was solely a matter of opinion involving the exercise of judgment and discretion), were in good faith and after full consideration, compromised and settled finally by an oral mutual agreement between the taxpayer and the Commissioner of Internal Revenue,

which agreement was thereafter fully executed by both the taxpayer and the government by the making of an amended return and payment of the tax in accordance therewith by the taxpayer and the acceptance thereof and the closing of the case by the government, may the taxpayer subsequently, in the absence of the showing of fraud, mistake of fact, new material evidence, or error in mathematical calculation, repudiate and set aside that agreement as to a particular item which it may regard unfavorable to his interests, and as to which, in such settlement the taxpayer voluntarily accepted and agreed with the Commissioner thereon, and recover against the United States in a suit in the Court of Claims on a claim that the judgment of the Commissioner as to that particular item was erroneous, and at the same time hold, by virtue of the agreement and the running of the statute of limitations against the government, the advantages derived from the executed compromise and settlement of the other items in dispute involved in the same general settlement? Is such an executed agreement of compromise and settlement binding, and, further, is not the taxpayer under those circumstances estopped from questioning the adjustment as to such particular item?

Preliminary Statement

In the Court of Claims, the Government very properly, as we believe, contended that such an executed agreement of settlement was binding on both the taxpayer and the Government, and that the claimant was estopped from questioning the adjustment, and filed in that Court what we believe and respectfully submit is an unanswerable brief to sustain those contentions (This brief, pp. 5-39).

The Court of Claims, by a unanimous decision, in which Judges Moss, Graham, Hay, Booth and Chief Justice

Campbell participated, sustained the contention of the Government (*Botany Worsted Mills v. United States*, 63 Court of Claims, 405).

On a motion of petitioner for a new trial in the Court of Claims, the Government contended that claimant was estopped to question the adjustment, but reversed its position as to binding force of the executed agreement of settlement, and filed a brief accordingly (This brief, pp. 42-48).

The Court of Claims denied the motion for a new trial, and we respectfully submit, properly (R. 27).

The brief of the Solicitor General just filed in this Court on behalf of the Government apparently abandons both defenses, and presents an argument against the binding force of the executed agreement of compromise and settlement and states that the findings do not disclose a ground for estoppel. The brief further states that in other cases now pending, the attorneys for the Bureau of Internal Revenue are taking the position that no such agreement of settlement and compromise is binding on either the taxpayer or the United States; but in deference to the opinion of the Court of Claims the question is submitted for the judgment of this Court.

We are counsel in an important case pending in the Board of Tax Appeals which was heard and submitted a year ago and which is not yet decided. This, we presume, is one of the cases to which the Solicitor General refers, and the case mentioned by counsel for petitioner in the petition for writ of certiorari in the case at bar (Record, p. 4).

We have labored under the misapprehension that the Government intended to support the decision of the Court of Claims by a brief. We were surprised to learn just last

week through Solicitor General Mitchell of the subsequent changes of attitude of the Government in the Court of Appeals in the case at bar. He invited us to file a brief herein as friend of the court, and through the courtesy of a motion made by him on April 23, 1928, permission was granted to us by this Court to file a brief amicus curiae not later than May 4, 1928. We were unable to obtain copies of the record and briefs of counsel until April 25, 1928. The lateness of our information and the very limited time at our disposal require that we ask the indulgence of this Court and that we be content to submit as a part of this brief amicus curiae, the brief filed by the Government in the case at bar in the Court of Claims. We adopt the statement of facts and argument therein and present the same in support of the decision of the Court of Claims, which we respectfully submit should be affirmed.

In its entirety, it is as follows:

In the Court of Claims of the United States

No. D—747

BOTANY WORSTED MILLS, CLAIMANT

v.

THE UNITED STATES, DEFENDANT

DEFENDANT'S REQUEST FOR FINDINGS OF FACT AND BRIEF

Statement of the Case

This is an action to recover the sum of $450,994.06, with interest, assessed against the Botany Worsted Mills and paid as additional income and excess profits taxes for the year 1917.

The only question in the case is the claim for allowance as a deduction as an ordinary and necessary expense paid within the year 1917 of $1,585,739.39, compensation to the ten directors of the company, instead of the sum of $782,-083.32, which was allowed by the Commissioner of Internal Revenue to be deducted as such an expense.

The Botany Worsted Mills, a New Jersey corporation, had in effect the following provision in its by-laws, which was adopted by meeting of the stockholders on March 17, 1908:

> Par. 2. At the close of the business year the net profits shall be distributed as follows, after suitable deductions shall have been made from the value of the property of the company:
>
> (1) A dividend of six (6) per centum is to be paid to the stockholders, in the computation of

which said dividend payable on September 15th of the same business year shall be included.

(2) The balance remaining is to be applied as follows:

(a) Five (5%) per centum thereof shall be placed in a reserve fund until the amount of the reserve fund accumulated shall be equal to twenty (20%) per centum of the paid-up capital of the company for the time being.

(b) A compensation equal to thirty-two (32%) per centum of the said balance shall be allowed or paid to the board of directors for their services.

The net income of the claimant in 1917 was $7,953,512.80, and it paid under that by-law the total sum of $1,585,739.39 to the ten directors, distributed as follows:

Thomas Prehn	$207,367.26
Ferdinand Kuhn	51,841.83
Hans E. Stoehr	362,892.74
Max W. Stoehr	103,683.64
Georg Rohlig	311,050.88
Camill A. Mehl	207,367.26
Otto Kuhn	103,683.64
A. de Liagre	103,683.64
Eduard Stoehr	85,626.38
Georg Stoehr	28,542.12

This was in addition to a salary of $9,000.00 paid to each of the first eight of said directors, no salary being paid to the last two.

Under that by-law the claimant had paid thirty-two per cent of its net income each year to its directors, and in none of the years from 1910 to 1916, inclusive, had the Commissioner of Internal Revenue allowed any of this payment to be deducted as an expense of the business in computing its income taxes. This decision of the Government was accepted by the claimant and no claim

against that ruling was made by the company for any of those years.

In filing its income tax return for the year 1917, the claimant sought to take as a deduction the payment of that amount made to the directors in 1917. The claimant was notified by the Government that that deduction would not be allowed, and that various other claims made in the return would be disallowed, which would result in a very largely increased tax against the claimant for the year 1917. Whereupon the company, through its attorney, John Quinn, asked for a conference on the subject. Many conferences were held and finally the various questions at issue were settled and agreed upon between the parties as a give-and-take proposition on the various items, the settlement was agreed to by the directors of the complainant, and the tax paid and the matter closed in the company's affairs.

The stockholders of the claimant corporation on July 30, 1918, amended the by-law quoted above and provided that the directors should receive "such sum *not exceeding* thirty-two per cent" of the balance of the net profits as the board of directors should determine. Thereupon, the board of directors allowed for compensation to the directors for the year 1918 approximately sixteen per cent of the balance of the net profits, which amount was satisfactory to the directors interested, and which amount was approved by the Commissioner of Internal Revenue and allowed as a deduction as a necessary expense for the year 1918. It was then agreed that the compensation to directors for the year 1917 should be of the same percentage or proportion of the net profits as was agreed upon by the directors of the corporation as a reasonable compensation for 1918, and which was approved by the Commissioner of Internal Revenue as a deduction as a necessary expense, and this percentage of sixteen per cent as the deduction

was allowed and agreed to for the year 1917 as a part of the settlement of all the items in dispute, and this tax was duly assessed and was paid June 28, 1920.

Thereafter, on February 1, 1922, the claimant filed a claim for refund for the amount at issue in this suit, which was denied by the Government on the ground that there had been a complete settlement of this item and of the other items which had been approved by and accepted by both parties.

The only question in the case is the right of the claimant at this time to increase its deduction as an ordinary and business expense, the percentage compensation or bonus paid to directors for the year 1917 from $782,083.32, the amount allowed to be deducted by the Commissioner of Internal Revenue, to the sum of $1,585,739.39, which would result in a decrease of the tax due and paid in the sum of $450,994.06.

DEFENDANT'S REQUEST FOR FINDINGS OF FACT

The defendant, deeming the facts stipulated to be material to a due presentation of this case in the findings of fact, requests the Court to find the same as stipulated, and also to find the facts as found by the Commissioner of Court of Claims in his finding No. XX from the testimony taken.

The Statutes

The applicable section of the Revenue Act of 1916 in force in 1917 provides as follows:

> SEC. 12. (a) In the case of a corporation joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the

gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.

ARGUMENT

1. The various tax matters of the company for the year 1917 were compromised and settled by mutual agreement and neither party may seek to cancel a part of that settlement

2. The amount paid the directors for 1917 was not an ordinary or necessary expense and was not a reasonable compensation beyond the amount allowed by the Commissioner of Internal Revenue

1. The various tax matters of the company for the year 1917 were compromised and settled by mutual agreement and neither party may seek to cancel a part of that settlement

The record in this case shows very clearly and plainly that the various matters in dispute regarding the taxes of the claimant for the year 1917 were compromised and settled by mutual agreement and the matter was closed by both parties. This is shown by the minutes of the claimant corporation and by the letters of its officers and attorney.

There were a number of matters disputed by the company, including the question involved in this suit, also depreciation and invested capital and a number of minor items.

Attention is called to the following parts of letters and of the minutes of the meetings of the directors of the corporation:

Exhibit 70 is a letter from the claimant to the Commissioner of Internal Revenue, dated January 17, 1918. (This letter was written by the old company, with the old board of directors, and before the Alien Property Custodian took over control of the stock of the company.)

> * * * Furthermore, we think that it will be to the interest of the Government as well as ourselves to have a definite understanding as to this subject of compensation paid to our directors, so that it may be settled once and for all—not only in reference to the year 1909, but also for the year 1917, and subsequent years.
>
> * * * * *
>
> For all of the above reasons we request a decision permitting us to charge this compensation as a deduction from gross income. (We beg to state in this connection that we do not make any claim for the intervening years, that is commencing with 1910 and ending with 1916, both inclusive, which we shall consider settled.)

Exhibit 32. Board meeting, July 11, 1919.

Exhibit 80. This is a letter written by the attorney for the claimant to the Commissioner of Internal Revenue, after the conference proposing the basis for the compromise and settlement of the matters of deduction for bonus and depreciation.

> (6) In accordance with Mr. Alexander's and Mr. James' suggestion that the principles adopted by the Board regarding extra compensation to executives and the amounts paid for the year 1918 would be adopted and applied to extra compensation for the year 1917, the Assistant Treasurer of the Company, Mr. W. J. Hellmer, has, in accordance with my direction, prepared and I inclose herewith a statement showing the reasonable compensation of the executives of the Botany Worsted Mills for

the year ending November 30, 1917, based upon the compensation to executives under contracts and under the recommendation of the special committee of the Board for additional compensation for the year ending November 30, 1918. This is the paper marked at the top in red ink "Exhibit 6."

* * * * *

Of the ten executives named on said list, Thomas Prehn, Ferdinand Kuhn, Otto Kuhn, and Camill Mehl served for the entire year, both in 1917 and 1918. Their reasonable compensation, therefore, for 1917 is based on their contract compensation for 1918, plus the additional compensation recommended by the Board of Directors for the year 1918. This, I think, explains itself from the statement.

* * * * *

* * * If the extension to the year 1917 of the principle adopted and approved for the year 1918 regarding extra compensation to executives, as shown in said Exhibit 6, be approved by your Department, as I respectfully submit justice and equity requires it should be approved, it will result in the disallowance by your Department of the difference between said $1,565,739.39 and the said sum of $782,083.32 arrived at in said Exhibit 6, or the sum of $783,656.08.

* * * * *

For the reasons stated by me to you, I should appreciate it if your Department can let me have its decisions and rulings in these matters for said two years as promptly as possible, in order that I may take the matters up with the Board of Directors of the company. For the reasons which I stated at the hearing it is desirable to have these open questions settled and closed as speedily as possible for the years 1917 and 1918.

P. S.—The report of the subcommittee on additional compensation to executives, composed as stated of Messrs. Wallace, Duvall, Maloney, and Howell, was unanimously approved by the Board. Of the eleven members of the Board, nine were nominated by the Alien Property Custodian, and two only—Ferdinand Kuhn, the President, and Thomas Prehn—remained over from the old Board. The other members of the Board who apprved the report of the subcommittee were: Mr. Horace C. Jones, a well-known wool expert and wool manufacturer of Conshohocken, Pa.; Mr. Wm. H. Folwell, of Folwell Brothers, large dealers in wool, of Phila., Pa.; Mr. Thomas F. Martin, the Sec. of State of N. J., a man of wide experience in business and of high standing in business and corporate affairs; Mr. Wm. J. Hellmer, the Assistant Treas. of the company and an expert accountant; and Col. Douglas I. McKay, an acknowledged expert in corporate management.

The subcommittee had many sessions on the subject of said compensation, and their report and the action of the Board in unanimously approving their report for the year 1918 was the result of their independent and disinterested judgment as to the reasonable requirements and the necessities of the company and of its business, and in the best interests of its stockholders and in entire good faith, for none of the nine directors nominated by the Alien Property Custodian is a stockholder of the company and not one participated to the extent of one dollar in any additional compensation or bonus.

Exhibit 34. Board meeting, August 22, 1919.

Exhibit 83. This is the official notice, dated September 11, 1919, from the Commissioner of Internal Revenue to the claimant, giving the amounts due for the 1917 taxes, and it states:

The adjustments referred to above have been made on the findings of the Revenue Agent and

also on the agreement reached in several conferences with Mr. John Quinn, your representative, of which you are, no doubt, familiar.

Exhibit 54 is a letter from the Assistant Treasurer of the company to its counsel, John Quinn, where it is stated:

> The amount of $783,656.06, disallowed as a deduction in 1917 for additional compensation to Directors, being the result of your previous conference with the Department, has already been accepted by the Company.

Exhibit 39. Board meeting, November 14, 1919.

Exhibit 41. Board meeting, December 12, 1919.

Exhibit 49. Board meeting, April 23, 1920, where it is stated:

> * * * Counsel succeeded some time ago in effecting a compromise on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and which was satisfactory to the board.
>
> The company then received an assessment of $1,144,821.02, covering the years 1916, 1917, and part of 1918. This assessment was the subject of careful consideration by the company and conferences with counsel and conferences with the Department by counsel, and the subject of supplemental memoranda and hearings.
>
> At the last hearing there was a great deal of discussion in regard to the reluctance of the Department to allow for those years the large items of bonuses to employees and deductions for reserves, but they finally agreed to allow the bonuses to employees, the deductions for reserves, and all of counsel's other points.

Counsel arranged an adjustment of the bonuses for the year 1917 on the same relative basis as the bonuses for the year 1918, approved by the reorganized board.

Assuming that the bonus to directors in 1917 will remain as originally agreed to, that is, on the relative basis of the 1918 bonus, the additional tax to the Government for the years 1916, 1917, and 1918 will amount to $718,770.11.

This shows a saving to the company between the original amount claimed and what will be the final assessment, of $663,507.16.

The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and facts.

* * * Counsel's opinion was that corporations may legally and properly make contracts with their executives for compensation on such basis as the directors of the company in good faith believe to be in the best interests of the company, and that the fact that such compensation may be in excess of the amounts ultimately allowed by the Department for income tax purposes, would not be the basis of a claim against the executives. * * *

Exhibit 92 is a letter dated May 12, 1920, from the attorney for the claimant to the Commissioner of Internal Revenue forwarding the amended returns compiled in accordance with the compromise and settlement agreements. It states:

Pursuant to the understanding arrived at at the conference held in Washington on April 9, 1920, between Mr. Akers, Mr. Kane, Mr. Hellmer, and myself, I enclose you herewith the following papers in the above matter:

* * * * *

These statements explain themselves and show in condensed form the differences between the reports as originally made, and the amended reports, herewith submitted, and the amended reports are in all respects based upon the conclusions arrived at at the preceding and last conferences.

* * * * *

The said amended returns and the above described enclosures give you fully and truthfully all of the details and computations which were discussed at the last conference, and the preceding conferences, and will, I am sure, enable the Department to make a speedy disposition of this matter. As Mr. Hellmer and I said at the last conference, by sending in the amended returns for said years, based upon the figures agreed upon, it will make the work of the department in checking up the returns, in the light of the enclosed papers, and the balance sheet which you already have simple and expeditious and exclude possibilities of error.

* * * * *

Upon their approval, I take it that the next step would be the rendition of new assessments for said three years, which will be promptly paid to the Collector of Internal Revenue for Newark, New Jersey, thus closing the entire matter.

After the figures were agreed upon and all the matters compromised and settled, the company executed an amended income-tax return for the year 1917, giving the figures as compromised and settled, and this amended return was reported to the board of directors at their meeting of May 14, 1920, as shown by Exhibit 50, in which the counsel for the company reported that he had examined and approved the amended income tax-return, that it had been forwarded with a full explanatory letter, and then said:

The next step will be the rendition of new assessments for the said three years and the payment of the additional taxes to the Collector of Internal Revenue at Newark, New Jersey, which will close the entire matter.

Exhibit 51. Board meeting, June 11, 1920.

> * * * it does not differ from the balance sheet previously submitted, except in respect of the increase of the amount of taxes due the Government as per the adjustment recently reached with the Department of Internal Revenue. * * *

Exhibit 57. Board meeting, June 16, 1920.

Exhibit 95 is a letter dated June 17, 1920, from the Assistant Treasurer of the company to the attorney of the company, in which it is stated:

> We enclose herewith copy of letter received yesterday afternoon from Mr. G. V. Newton, Deputy Commissioner of Internal Revenue, dated June 15, 1920, advising that upon reaudit of our tax returns for the fiscal years ended November 30, 1916, 1917, and 1928, additional taxes amounting to $710,969 were disclosed.
>
> By comparing the enclosed letter with your letter of May 12, 1920, to the Hon. Wm. M. Williams, Commissioner of Internal Revenue, Washington, D. C., you will note that the Department has accepted our returns for 1916 and 1918 as rendered, said returns showing an additional tax due for 1916 of $7,390.63 and a refund due us for 1918 of $116,281.61. You will also note that for the year 1917, they show additional tax due of $819,859.98, whereas your letter shows additional tax due of $808,021.37, making a difference of $11,838.61.

Exhibit 97, being a letter dated June 23, 1920, from the attorney of the company to the Commissioner of Internal

Revenue referring to taxes for the year 1917, in which he says:

> Thanking you for your courtesies in this matter, and with appreciation of the fact that it is finally closed up, which enables the Botany to finally close its books for those years, I am. * * *

Exhibit 52. Board meeting, June 25, 1920.

> For the year 1917 the figures given by the Department showed additional taxes due of $819,-859.98, whereas the figures agreed upon between Mr. Quinn and the Department for that year showed additional taxes due of $808,021.37, making a difference of $11,838.61 of additional taxes.

Exhibit 99 is a letter dated June 29, 1920, from the Assistant Treasurer of the company to the attorney for the company, in which it is stated:

> However, the payment has now been made and I hope the matter is closed as I agree with you that to contest their ruling regarding the amount of $11,838.61 might open the door for further assessments covering said years.

Exhibit 101 is a letter from the attorney of the company to the office of the Commissioner of Internal Revenue, dated July 17, 1920, after the tax had been paid as compromised and agreed upon, in which counsel says:

> I am obliged by the receipt of your letter of July 14th giving the basis of the computation of the tax for the fiscal year 1917, in answer to the claim for a difference of $11,381.61 as set forth in my letter of June 23, 1920, to you. The tax was paid in full on June 28, 1920, in accordance with your ruling. I have sent a copy of your letter of July 14, 1920, to the Botany Worsted Mills for its records, and the matter is now closed.

In the testimony given by the witnesses for the Government, all of whom had participated in one or more of the conferences with representatives of claimant on these matters, it is stated that the various matters were settled and compromised as a give-and-take proposition and that more was allowed on one item and less on another item in order to have the whole matter settled and compromised.

The claimant introduced no testimony whatever and called none of its representatives who took part in these conferences.

The record, therefore, plainly and positively shows that all of the matters in controversy between plaintiff and the Government as to taxes for 1917 were agreed to, compromised, and settled as a whole and no one item by itself, but the entire compromise was dependent upon the settlement of each and every item.

The fact that the agreement was "a gentlemen's agreement," that is, it was not reduced to writing, makes no difference. It was accepted and executed by both parties, and became an executed contract. It could then be rescinded only for fraud or mistake, neither of which is claimed in this case, and even then only by restoring the status which existed before.

Ostrum v. *City of San Antonio,* 71 S. W. 304.

McLean v. *Clapp,* 141 U. S. 429.

Grymes v. *Sanders,* 93 U. S. 55.

That a compromise settlement, which has been agreed to and executed, is closed and can not be opened up by one of the parties, has lately been decided by this Court in the case of *The Lone Star Brewing Association* v. *United States,* decided November 2, 1925. This Court said:

> The cause of action presented by the plaintiff in its petition arises from transactions having to do with the taxes and penalties of 1916 and 1917, and we can not go back of the agreement of the parties and open up a transaction which has been closed by the act of the parties.
>
> (Case not reported yet.) T. D. 3778.

A petition for certiorari in that case was denied by the Supreme Court, 271 U. S. 680.

A similar case has very lately been decided by the Circuit Court of Appeals for the Fifth Circuit, in which case the court said:

> A party against whom taxes have been assessed is at liberty to make or accept or to refrain from making or accepting an offer of compromise. The making of an offer of compromise is a voluntary act, and the contract resulting from its acceptance is binding on a party unless his consent to the contract was illegally obtained. (*Ostrum* v. *City of San Antonio*, 71 S. W. 304; *Palomares Land Co.* v. *Los Angeles County*, 146 Calif. 530; *Lee* v. *Inhabitants of Templeton*, 15 Gray 476.) * * * The payments now in question were made, not in compliance with any official demand or statutory requirement, but in pursuance of an agreement to which the plaintiff was a party, and without protest or notice that in making or complying with that agreement the plaintiff acted otherwise than voluntarily. The making of that agreement was authorized by the statute providing for the compromise of any civil or criminal case arising under the internal revenue laws. R. S. 3229, Comp. Stat. #5952.) A compromise by which the authorized representatives of the Government agreed to take, and the plaintiff agreed to pay, a less sum than had been assessed against the latter, had the effect of extinguishing the controversy between the parties to the contract. (*Little* v. *Bowers*, 134 U. S. 547, 556.)

The matters which were in controversy between the parties to the compromise before it was made are not subject to be reopened if the compromise was binding on the parties, and the question whether it was binding is determined by rules applicable to contracts generally. A payment made pursuant to a contract can not be recovered back without annulling or canceling the contract, and that can not be done unless the payer's consent to the contract was illegally obtained, or without his taking prompt action to annul or avoid the contract and restoring the status which existed before the payment was made. The party seeking to get back what he has paid can not retain the benefits of the contract and escape its burdens. (*McLean* v. *Clapp*, 141 U. S. 429; *Grymes* v. *Sanders*, 93 U. S. 55; *Multnomah* v. *Title Guaranty & Trust Company*, 46 Oregon, 523.) The indictment mentioned having been dismissed pursuant to the compromise agreement, it is obvious that it was impossible to restore the status which existed before that agreement was made. In the situation which existed between the date of the making of the demand that plaintiff pay the amount of the assessment finally made and the date of the compliance with the compromise agreement it was open to the plaintiff either to pay under protest the amount assessed and sue for the whole or any part thereof claimed to have been erroneously or illegally assessed or collected (Comp. Stat. 5949), or to avail itself of an opportunity to settle by compromise the matters in controversy. It chose the last-mentioned alternative. By this suit it claims that it was as free to attack the assessment as it would have been if it had chosen the other alternative. No finding made indicates that in making the compromise the plaintiff acted without full knowledge of all the circumstances, or that it was influenced by any constraint except such as resulted from the facts that when the agreement was made the above-mentioned indictments against one of its officers was pending

and the collector had means of promptly enforcing collection of the assessment made. * * *

The court's ruling was to the effect that the plaintiff was entitled to treat the compromise agreement as a nullity and to maintain an action to recover back the amount wrongfully assessed, because at the time that agreement was made plaintiff was subject to be coerced to pay a larger sum than the one it agreed to pay and its representative was subject to be tried under the indictments against him, though the plaintiff did not promptly take action to avoid or annul the compromise agreement and could not restore the status which existed before that agreement was made and complied with. We are of opinion that that ruling was erroneous, and that on the state of facts found plaintiff was not entitled to recover back the whole or any part of the sum it paid in pursuance of the compromise agreement.

Walker v. *Alamo Foods Co.* (Not yet reported.) Decided January 4, 1927.

The Circuit Court of Appeals for the Second Circuit also has held that where a compromise has been accepted and executed, the Government may not then ignore the settlement and bring the other party into court on a matter which was covered by the compromise agreement. (*Rau* v. *United States,* 260 Fed. 131.)

In these cases the compromise was offered and accepted under Section 3229 R. S. But the rule is general and is just the same under a compromise settlement made under the general principle of contract. Or as the Court said in the *Alamo Foods case, supra:*

> The matters which were in controversy between the parties to the compromise before it was made are not subject to be reopened if the compromise was binding on the parties, and the question whether it was binding is determined by rules applicable to contracts generally.

In those cases the record shows that the compromise was expressly offered and accepted under Section 3229 R. S. In the case at bar the record does not show if the compromise was made under that section or that the provisions of that section were not complied with. But in any case that section is not exclusive, particularly in a case of this character.

The various matters being considered in this case, viz, a fair and reasonable compensation for directors, and a proper amount to be allowed for depreciation, are not certain and fixed amounts which can be absolutely determined. But they are matters which depend upon the ideas and judgment of the individual who passes on them; and in questions involving such large amounts as in this case, it is certain that there would be wide differences in the resulting judgment and conclusion of the different individuals who sought to determine them.

These are, therefore, matters which, when conferences were held and the results were satisfactory to both parties, almost necessarily must have been determined and settled by compromise and agreement.

The right and power exist to determine such matters by agreeing upon the various amounts or matters in controversy, and the right to settle and compromise a claim or demand under the rules applicable to contracts is well settled.

It is a principle settled by the Supreme Court of the United States that disputed claims by or against the United States may be compromised and settled without suit or trial.

> Unconditional acceptance of the medium of payment different from that promised by the United States, or absolute acceptance of a smaller sum from the Secretary of the Treasury than the one

claimed from the United States, even in a case where the amount relinquished is large, does not leave the United States open to further claim on the ground of duress, if the acceptance of the different medium or the smaller sum is voluntary, and without intimidation, and with a full knowledge of all the circumstances; nor is the case changed if it appears that the claimant was induced to accept the different medium or the smaller sum in full as a means to secure an earlier payment of the claim than he could otherwise hope to procure. (*Mason* v. *United States*, 17 Wall. 74.)

Parties having claims against the United States, which are disputed by the officers authorized to adjust the same, may compromise the claim, and may accept payment in a different medium from that promised, or may accept a smaller sum than that claimed; and where it appears that the claimant voluntarily entered into a compromise, and accepted payment in full in a different medium from that promised, or accepted a smaller sum than that claimed, and executed a discharge in full for the whole claim, or voluntarily surrendered to the proper officer the evidences of the claim for cancellation, he can not subsequently sue the United States, and recover in the Court of Claims for any part of the claim voluntarily relinquished in the compromise. (*Sweeney* v. *United States*, 17 Wall. 77; *United States* v. *Child*, 12 id. 244; *United States* v. *Justice*, 14 id. 549.)

Decisions of the kind by this court are quite numerous, and they show beyond all doubt that parties may adjust their own controversies in their own way, and that when they do so voluntarily, and with a full knowledge of their rights and all the circumstances, no appeal lies to the courts to review their mutual decision. Courts can not make contracts for parties; and if parties understandingly contract to adjust a controversy between them in a particular way, and actually execute the contract,

> they are both bound to regard the controversy as at an end. (*Savage, Exec.*, v. *United States*, 92 U. S. 382, 388-389.)

This general principle of law with regard to claims by or against the United States was not abrogated or repealed by Section 3229.

And while the record does not show if this settlement and compromise was made under Section 3229, it is valid whether made under that section or without it.

Claimant's argument in his brief that the "gentlemen's agreement" could not have been enforced by claimant against the Government is beside the question. We are considering an *executed* agreement, not the power to compel the carrying out of an oral or gentlemen's agreement. The decisions of the Supreme Court quoted above, are decisive of the validity of the executed agreement or compromise as in this case.

That the claimant made the settlement or compromise, that it was fair and right and just to claimant, that claimant was anxious to make the settlement, and that claimant received all which it believed was right and proper under the law and the facts and that the matter was closed by claimant are shown by the statements of claimant's officers and the minutes of the meetings of its Board of Directors.

Thus in Exhibit 80, claimant's attorney writes:

> If the extension to the year 1917, of the principle adopted and approved for the year 1918, regarding extra compensation to executives, * * * be approved by your Department, as I respectfully submit *justice and equity requires it should be approved,* * * * it is desirable to have these open questions *settled and closed* as speedily as possible for the years 1917 and 1918. * * *

> Their report and the action of the Board in unanimously approving their report for the year 1918, was the result of *their independent and disinterested judgment* as to the reasonable requirements and the necessities of the Company and its business, and *in the best interests of its stockholders* and *in entire good faith.*

In Exhibit 54, the Assistant Treasurer of claimant writes:

> The amount of $783,656.06 disallowed as a deduction in 1917 for additional compensation to Directors, being the result of your previous conference with the Department, *has already been accepted by the Company.*

In Exhibit 49 the minutes of the Board show that its counsel reported:

> *Counsel succeeded* some time ago in *effecting a compromise* on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and *which was satisfactory to the board.* * * * *The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and facts.*

In Exhibit 92, a letter from the attorney for claimant, he writes:

> The said amended returns and the above described inclosures give you fully and truthfully all of the details and computations which were discussed at the last conference, and the preceding conferences, and will, I am sure, enable the Department to make a speedy disposition of this matter. * * * Upon their approval, I take it that the

> next step would be the rendition of new assessments for said three years, *which will be promptly paid* to the Collector for Newark, New Jersey, *thus closing the entire matter.*

In Exhibit 50, the Board minutes state that the attorney for claimant reported that he had examined and approved the amended income tax returns (which were executed by the President and Assistant Treasurer of the claimant. Exhibits 107-110), and he said:

> The next step will be the rendition of new assessments for the said three years and the payment of the additional taxes to the Collector of Internal Revenue at Newark, New Jersey, *which will close the entire matter.*

In Exhibit 97, the attorney for claimant writes:

> with appreciation of the fact that *it is finally closed up,* which *enables the Botany to finally close its books* for those years.

In Exhibit 52 the Board minutes speak of "the figures agreed upon between Mr. Quinn and the Department."

In Exhibit 99 the Assistant Treasurer of the claimant, who participated in the conferences writes:

> the payment has now been made and *I hope the matter is closed* as I agree with you that *to contest their ruling* regarding the amount of $11,838.61 *might open the door for further assessments* covering said years.

This shows that claimant knew it has settled some of the matters in dispute for less than it might be liable to pay.

In Exhibit 100 the attorney for claimant writes the Commissioner of Internal Revenue:

> *The tax was paid in full* on June 28, 1920, *in accordance with your ruling.* I have sent a copy of

> your letter of July 14, 1920, to the Botany Worsted Mills *for its records, and the matter is now closed.*

Claimant states in its brief (p. 35):

> That the plaintiff's directors did not consider that a compromise settlement had been made or authorized is shown by the fact that the Company, on February 1, 1922, while still controlled by the Alien Property Custodian, filed with the Commissioner a claim for refund.

Of course even if this were the fact, it would simply show that the claimant, while retaining the benefits it had received from the compromise settlement, was seeking to recover from the Government what the Government had received for its consideration.

But the record does not show what is stated above, but quite the contrary.

The only directors in 1921 and 1922, who were directors in 1918, are Ferdinand Kuhn and Horace C. Jones (stipulation, paragraphs XXVI, XXXV). Also, the record does not show that the directors had anything to do with the claim for refund (stipulation, paragraph V).

And the record does show that there was a different Alien Property Custodian in 1922 and a new attorney for the claimant, who did not have copies of the material correspondence regarding the compromise settlement and did not know what had been done, and was not conversant with the facts in the case.

After the claim for refund was rejected, the new attorney for the claimant wrote the Commissioner of Internal Revenue on October 3, 1922, as follows:

> The letter of September 26th refers to letters of June 23 and July 17, 1920, and Mr. John Quinn, then the attorney of the Alien Property Custodian,

> upon which letters apparently considerable weight is placed in reaching your decision. As I have never had the privilege of seeing these letters, I respectfully ask that copies of the same be forwarded to me so that I may be fully conversant with all of the facts in the case. You will appreciate that I am asking this because the present Alien Property Custodian had no previous connection with the case and was not represented by Mr. Quinn, and therefore we have no copies of these letters available. (Exhibit 104.)

It is submitted that this letter shows conclusively that the claim for refund was prepared and filed by parties who did not know what the facts were nor what had been done in the matter.

It is submitted that there was an agreement of settlement or compromise which was executed and which was so understood by all the parties, including the Board of Directors of the claimant, as is shown by the testimony of all witnesses in the case who had knowledge of what had been done, as well as the letters of the officers of the claimant to its attorney, and the letters of the attorney for the claimant, and the minutes of the Board of Directors of the claimant. That the questions sought to be raised in this case were considered and discussed at the time and that the attorney for claimant notified the Board of Directors of claimant that "The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and the facts." That it is not alleged or claimed that there was any mistake or fraud in the matter, and no offer or attempt is made to put the parties in status quo.

It is therefore submitted that the executed agreement or compromise is a bar to this action.

2. The amount paid the directors for 1917 was not an ordinary or necessary expense and was not a reasonable compensation beyond the amount allowed by the Commissioner of Internal Revenue.

The statute allows a deduction for "All the ordinary and necessary expenses paid within the year." (Act 1916, Section 12 (a). First.)

The Regulation duly issued on this point is as follows:

> Art. 138. Bonuses or additional compensation.—Special payments, sometimes denominated as gifts or bonuses to employees of corporations, will constitute allowable deductions from gross income in ascertaining net income for the purpose of the income tax, when such payments were made in good faith and as additional compensation for the services actually rendered by the employees. If such payments, when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered, they will be regarded as a part of the wage or hire of the employee, and therefore an ordinary and necessary expense of operation and maintenance, and as such deductible from gross income.
>
> Special payments made to officers or employees who are stockholders, in the guise of additional salaries or compensation, the amount of which is based upon or bears a close relationship to the stockholdings of such officers or employees or the capital invested by them in the business of the company, will be regarded as a special distribution of profits, or compensation for the capital invested and not payment for services rendered. Payments under such latter conditions being in the nature of dividends, will not be deductible from gross income.
>
> Salaries of officers or employees who are stockholders will be subject to careful analysis, and if they are found to be out of proportion to the volume of business transacted, or excessive when compared with the salaries of like officers or employees

> of other corporations doing a similar kind or volume of business, the amount so paid in excess of reasonable compensation for the services will not be deductible from gross income, but will be treated as a distribution of profits. (Regulations 33.)

The regulation was a valid interpretation of the law; and by the reenactment of the law of Congress, Congress is presumed to have recognized and approved the regulation and practice of the Department.

Provost vs. United States, 269 U. S. 443.

United States vs. Anderson, 269 U. S. 422.

Baltzell vs. Mitchell, 3 Fed. (2d) 428, 430.

But it is so much stronger in this case because in the Law of 1918, Congress, in order to avoid any question or doubt, added words which practically made the regulation an express part of the law, and provided:

> All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered. (Act 1918, Sec. 234 (a) (1).)

The by-law of the claimant under which the payments were made is as follows (italics ours):

> Article 21. Par. 1. After the close of the first half of every business year of the company *a computation of profits shall be made.* * * *
>
> Par. 2. At the close of the business year *the net profits shall be distributed as follows*, after suitable deductions shall have been made from the value of the property of the company:
>
> (1) A dividend of six (6%) per centum is to be paid to the stockholders * * *.

(2) The balance remaining is to be applied as follows:

(a) Five (5%) per centum thereof shall be placed in a reserve fund * * *

(b) A *compensation* equal to thirty-two (32%) per centum of the said balance shall be allowed or paid *to the Board of Directors for their services.*

(c) The residue is to be applied to the payment of an additional dividend to the stockholders, * * *. (Exhibit 8.)

It is thus clearly stated that the amount paid is part of the distribution of the *net profits*, and is not a part of the salaries paid as expenses.

After all expenses have been paid and suitable deductions have been made from the value of the property, the net profits are distributed by paying a 6% dividend, then this payment as compensation to the board of directors for their services, and then the balance is paid as an additional dividend.

So that this amount is not expenses at all, but a part of the distribution of the net profits.

The Act of 1916 as other acts provides:

That there shall be levied, assessed, collected, and paid annually upon the total net income received * * *. (Act 1916, Sec. 10.)

So that there is at least a strong doubt if any payments made from the "*net profits*" of the company, after salaries and all other expenses are deducted, may then be deducted as salaries or expenses.

These payments are not salaries, for *directors* do not receive salaries. Each director had, however, received a salary of $9,000.00 for the year 1917 (Stipulation III)

which had been raised from $6,000.00, which was the amount paid from 1908 to 1916. Whether this salary was for his services as a director or for other services, the record does not show.

Claimant does not contend in its brief or elsewhere that the amount paid in 1917 to any director was *reasonable* and of course it cannot successfully so contend. In fact, claimant in its brief does not mention the amount paid to any director.

The facts show that the payments were extraordinary in amount, and must be so conceded by anyone.

They show that one director in addition to his salary was paid in 1917 *over $362,000.00*. Almost five times the salary of the President of the United States! The other directors in addition to their salaries were paid over $311,000.00, $51,000.00, $207,000.00, and $103,000.00 each. (The two who served only part of the year are considered later.) Stupendous sums, and not a word offered to show what services were rendered, if any, or what the services were worth. The record shows what position or office was held by each director but nothing regarding what services he rendered. But these sums were paid as compensation for the services of the *director* only.

A director's services, as director, are in serving on the board of directors, attending the meetings, and taking part in the discussion of the matters coming before the board, and voting thereon. But the record does not show what of such or other services were rendered by any of the directors during this year. But the record does show that services rendered had no relation to this payment. This is shown by the following:

(a) Eduard Stoehr and Georg Stoehr were living in Germany during 1916 and 1917, so that they could not attend any meetings or render any services as director.

(b) These two were German citizens, living in Germany, and were unable to leave that country (*if* they desired to). War with Germany was declared by our country on April 6, 1917. Yet these two were allowed compensation as directors of claimant until June 30, 1917.

(c) Neither of these received any salary from claimant in 1915 or 1916.

(d) Eduard Stoehr held no position with the company in 1917 other than as a director.

(e) At a meeting of the board of directors held on August 29, 1918, counsel advised that 5/12ths of the compensation for the year 1917 of these two directors, being for the period after their resignation, should be distributed among the remaining directors. So over $81,000.00 additional was given to the eight directors who had already received such huge sums from the *net profits* as "compensation," which, of course, had no relation to any services whatever, and was not compensation for anything. (Exhibit 20.)

These stupendous sums, being part of the net profits distributed to these parties who were directors, were *extraordinary*, and can not be considered or called "*ordinary* expenses" under any circumstances or conditions. Nor were they necessary expenses.

The by-law of the company could be changed at any time, and in fact was changed at the meeting held on July 30, 1918. This amendment, among other things, changed "32%" to "not exceeding 32%," and in accordance therewith the amount was cut to 16% for the year. Though eight months of the fiscal year had passed, it was not claimed that the company did not have the right to amend or repeal the by-law.

Counsel for claimant also advised its board of directors that the question of the legality of a contract for compensation between the corporation and its executives was distinct from the question of the amount which would be allowed by the Department for income-tax purposes. (Exhibit 49.)

Attention has heretofore herein been called to the fact that the board of directors approved the report of the committee for 1918, which was for the percentage, 16%, which claimant asked the Commissioner to allow for 1917 (and stated *justice and equity* required it should be approved by the Commissioner) and that report "was the result of their independent and disinterested judgment as to the reasonable requirements and the necessities of the company and its business, and in the best interests of its stockholders and in entire good raith." And counsel told the board of directors "The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the *officers of the company felt were right and proper under the law and facts.*"

The fact that no deduction for these extraordinary payments was taken or allowed for the years 1910 to 1916, inclusive, and the company made no claim for these years and considered them as settled (Exhibit 70) shows that the claimant felt and knew that these extraordinary payments to the directors were not ordinary and necessary expenses, and the claimant did not consider them as such.

The record shows that each director was a stockholder, but in a small amount, so that the extraordinary compensation to him as a director was not in proportion to his stockholding. It does show, however, a close relationship between some of the stockholders and the holders of the main stock of the company. And only some such personal

relationship could explain or countenance the payment of $86,000.00 for 1916 and of $113,000.00 (for seven months) of 1917 to two directors who were in Germany all of this time and could not act as directors, or render any service to the company for these large sums.

The law reports show, so far as has been found, no case in which compensation to *directors* has been considered. The question of salaries paid to executives is a different question, (but one in which the position of the taxpayer is much stronger. However, even these cases all support the Government's position in this case.

In *Jacobs & Davies, Inc., vs. Anderson,* the Circuit Court of Appeals for the Second Circuit said:

> They called those sums "compensation," but the court held that they must be treated as income of the corporation. To enable the company to deduct these amounts it must appear that they were paid as salaries for services actually rendered.* * * They were not compensation, because the salaries of both the parties are fully provided for in the agreement of April, 1909. It seems plain that they were profits of the business and as such were subject to the tax. Their payment did not depend on the services rendered. Whether the stock was distributed among a large number of holders or only two, it can hardly be maintained that the amount paid out in dividends should be deducted in order to ascertain the amount of the net income of the corporation. That must be determined by deducting from the gross amount of the income all ordinary and necessary expenses actually paid within the year. The distribution of surplus profits was not an ordinary and necessary expense paid in the maintenance and operation of the business. (*Jacobs & Davies, Inc. vs. Anderson,* 228 Fed. 505, 506.)

In *United States vs. Philadelphia Knitting Mills Company* the Circuit Court of Appeals for the Third Circuit held that the Government could not inquire whether salaries were reasonable, but the court's attention was not called to any regulation on the subject, and this was not considered by the court. And what the court said on this question is merely dictum, for it decided that the payments made were not for services actually rendered, but were a diversion of profits. The court said:

> To be a necessary expense it must have been paid for services actually rendered. (*Jacobs & Davies, Inc., vs. Anderson*, 228 Fed. 505, 506, 143 C. C. A. 87.) * * * But, while the amount of salary fixed by the board of directors is presumptively valid, it is not conclusively so, because the Government may inquire whether the amount paid is salary or something else. Admittedly the Government has a right to collect taxes on net income of a corporation, based on profits after all ordinary and necessary expenses, including salaries, are paid. It has a right, therefore, to attack the action of a board of directors and show by evidence, not that a given salary is too much, but that, in the circumstances, the whole or some part of it is not salary at all, but is profits diverted to a stockholding officer, under the guise of salary and as such, is subject to taxation.
>
> Of the same opinion was the learned trial judge, though in entering judgment of non-suit he raised and ruled upon a second question which was, not whether the salaries paid were commensurate with the services rendered, but whether there was evidence which would sustain a finding that the sums paid were not all salaries but were part profits.
>
> On this evidence we think a jury could find that, as the increase of Bilyeu's salary as president was made without a corresponding increase of service or business responsibility—in fact, in the face of a

> progressive decrease of service and responsibility—the amount paid him was not all for services rendered. (*U. S. vs. Philadelphia Knitting Mills Co.*, 273 Fed. 657, 658-660.)

In *Becker Bros. vs. United States*, the Circuit Court of Appeals for the Second Circuit again (in June, 1925), under the 1909 Corporation Excise Tax Act and the 1913 Revenue Act, held that the salaries which are paid, in order to constitute an allowable deduction, must be a reasonable and fair compensation for the services rendered. The court said:

> The first question to be considered is whether an error was committed in not deducting from the gross income the so-called salary of "85 per cent of the net profits" which the corporation agreed to pay annually to Jacob H. Becker as general manager of its business. The United States in fixing the amount of the tax assessed against defendant, declined to deduct 85 per cent of the profits as being the salary of Becker for his services, and instead deducted in each year only $10,000, claiming that such amount was a reasonable compensation for the services he rendered. There can be doubt that the corporation was entitled to deduct from the income it received all the ordinary and necessary expenses incurred in carrying on its business, including a reasonable compensation to its officers and employees. But the salaries which are paid in order to constitute an allowable deduction must be a reasonable and fair compensation for the services rendered. The expenses which can be deducted are the "ordinary and necessary expenses." If a corporation sees fit to pay its employees extraordinary, unusual, and extravagant salaries, distributing the profits of the business in the guise of salaries to its officers, who hold the stock and control its affairs, such salaries manifestly do not constitute the "ordinary and necessary expenses" of the business, which can be de-

> ducted under the statute. The government is not bound or concluded either by any resolution which the corporation adopts, or by its method of keeping its books, upon the question as to whether any particular payment is a salary payment or a division of surplus. (*Becker Bros. vs. United States,* 7 Fed. (2d) 3, 6-7.)

No authorities have been found questioning in any way these statements.

In the case in hand, claimant asked "In justice and equity" that the same percentage be allowed in 1917 as in 1918, and this was agreed to by the Commissioner, and 16% was allowed instead of 32%.

Therefore, the Commissioner allowed to be deducted as compensation to the directors for 1917 over $181,000.00 to one, $25,000.00 to another, $103,000.00 to each of two, $155,000.00 to another, $51,000.00 to each of three, and $57,000.00 to the two who were in Germany. These are certainly stupendous sums for directors' compensation, and even these, which were allowed, would be extraordinary, and not ordinary expenses.

CONCLUSION

It is submitted that all of the taxes of claimant for 1917 were agreed to, settled, and compromised, and claimant may not now seek to have one item of that settlement set aside. That the amounts paid the directors were from net profits after expenses had been paid, they were not salaries, they were extraordinary and unusual, and were not ordinary or necessary expenses of the corporation. That these amounts were not paid for services rendered or in proportion thereto. And that even the amounts agreed to and allowed by the Commissioner were more than reason-

able, and were more than need have been allowed, if any such payment must be allowed as a deduction. That the petition should be dismissed.

Respectfully submitted,

HERMAN J. GALLOWAY,
Assistant Attorney General.

R. C. WILLIAMSON,
Attorney.

(Credit in the preparation of this brief is acknowledged to Frederick W. Dewart, Special Attorney, Bureau of Internal Revenue.)

Decision of Court of Claims

The Court of Claims, by a unanimous decision in which Judges Moss, Graham, Hay, Booth and Chief Justice Campbell participated, sustained the contention of the Government that the various tax matters of the plaintiff for 1917 were finally settled by compromise and mutual agreement executed by both, and that, under the circumstances, the plaintiff should not be allowed a recovery, the opinion, in part, reading as follows:

> "It is not claimed by the Government that plaintiff's taxes were settled under the provisions of Section 3229. The theory upon which its defense on this point is based is that an agreement was entered into between plaintiff and the Commissioner of Internal Revenue under which plaintiff accepted the partial disallowance as to compensation, and also received certain concessions as to other disputed items, the benefit of which it still enjoys, and that, therefore, plaintiff is estopped from recovery in this action. In addition to the question of compensation there was pending at the same time and for the same year the question of depreciation and also the question of reserves charged to expenses. These items involved important amounts. All matters in dispute between plaintiff and the Government were settled, and the 1917 taxes were paid in accordance with the agreements theretofore reached in conference in the Internal Revenue Bureau. The negotiations in the bureau extended over a period of several months, involving considerable correspondence and numerous conferences."
>
> * * * * *
>
> "With the payment of the tax under the circumstances surrounding this case the agreement, which is mentioned in the record as a 'gentlemen's agreement,' became in legal effect as executed contract of settlement. Plaintiff now seeks to recover on

account of the particular item, which it regards as unfavorable to its interests, and at the same time hold to the advantage derived from the settlement of other items in dispute involved in the same general settlement.

It is the opinion of the court that plaintiff should not be allowed a recovery. It is therefore adjudged that the petition herein should be, and the same is hereby, dismissed."

Further Discussion of Estoppel

We further present the brief of the Government in reply to the brief of claimant on the motion for a new trial in the Court of Claims. In so doing, we respectfully disagree with the contention of the Government therein that the executed agreement of compromise and settlement in the case at bar was not binding. In fairness to counsel for the Government, we here print the reply brief in its entirety. We adopt the statement of facts and that portion of the reply brief supporting the contention that petitioner was estopped to question the adjustment to the particular item involved in this suit.

The brief is as follows:

In the Court of Claims of the United States

No. D—747

BOTANY WORSTED MILLS

vs.

THE UNITED STATES

ANSWER TO CLAIMANT'S PETITION FOR REHEARING AND NEW TRIAL

(May 21, 1927)

As the brief of claimant on the motion for new trial seems to be beside the law and the decision of the Court in this case it is deemed advisable to file a short answer thereto.

The Court's nineteenth finding of fact is as follows:

> An investigation of the books of the plaintiff by a representative of the defendant disclosed to the Commissioner of Internal Revenue the necessity of making a different assessment against the plaintiff than appeared due from its said return for the year ending November 30, 1917. The taxes for the said year were to be determined by the settlement of questions relating to the bonus paid to the company's directors, excessive depreciation charged off on the books of the company, and reserves charged to expenses.
>
> After much correspondence and numerous conferences extending over a period of several months in which the plaintiff was represented by its attorney, John Quinn, and by its assistant treasurer, W. J. Helmer, and other parties, and the defendant represented by Sidney Alexander, chief of the special audit section, Bureau of Internal Revenue, and others of his official associates, a com-

promise was agreed to as to all of the differences. In the said conferences Alexander informed Quinn that in view of the fact that the organization controlled by the Alien Property Custodian had considered the compensation paid to the directors for the year 1918 as being fair and reasonable, the same conclusion "could be reached upon the part of the Government in considering it a fair and reasonable amount for 1917." The results of the said conferences were reported by Quinn to the plaintiff's board of directors from time to time during their continuance.

The following is an excerpt from the minutes of a meeting of plaintiff's board of directors held April 23, 1920:

"• • • Counsel succeeded some time ago in effecting a compromise on the question of bonuses to directors and the amount transferred from depreciation on buildings and machinery to the surplus account, as to which counsel made a report to the board and which was satisfactory to the board.

"The company then received an assessment of $1,144,832[illegible]1.02, covering the years 1916, 1917, and part of 1918. This assessment was the subject of careful consideration by the company and conferences with counsel and conferences with the department by counsel, and the subject of supplemental memoranda and hearings.

"At the last hearing there was a great deal of discussion in regard to the reluctance of the department to allow for those years the large items of bonuses and deductions for reserves, but they finally agreed to allow the bonuses to employees, the deductions for reserves, and all of counsel's other points.

"Counsel arranged an adjustment of the bonuses for the year 1917 on the same relative basis as the bonuses for the year 1918, approved by the reorganized board.

"Assuming that the bonus to directors in 1917 will remain as originally agreed to—that is, on the relative basis of the 1918 bonus—the additional tax to the Government for the years 1916, 1917, and 1918 will amount to $718,770.11.

"This shows a saving to the company between the original amount claimed and what will be the final assessment of $663,507.16.

"The Government accepted the contentions presented by counsel for the company on all of the essential questions that counsel for the company and the officers of the company felt were right and proper under the law and facts."

Thereafter amended returns were prepared and executed by plaintiff's executive officers, based upon the figures as agreed upon in the said conferences, and were filed with the Commissioner of Internal Revenue, together with documentary evidence which it was agreed upon at the last conference should be furnished, and the tax so computed, with a slight change not material to this case, was paid by the plaintiff.

The above-quoted finding of fact is supported by the evidence in the record and by the findings of Commissioner Whaley. It thus appears that the adjustment of claimant's tax liability for the year ending November 30, 1917, involved the settlement of disputes relating to proper compensation of officers, correct depreciation, and the proper treatment, for invested capital purposes, of certain reserves charged to expense. After extended correspondence and numerous conferences lasting over a priod of months a settlement of the items was agreed upon by the representatives of the taxpayer and of the Government. That a mutual adjustment of all the differences was arrived at by an attempt in good faith to give and take with respect to the disputed items is shown by the

excerpts from the minutes of the taxpayer's board of directors and the findings of fact.

Under the facts as found by the Court in this case it appears that concessions were made by the Government because of concessions being made by the taxpayer; that in the absence of such mutual concessions these adjustments would not have been made. Under the circumstances as briefly outlined above, the claimant, while retaining the benefits of concessions made by the Government, seeks to repudiate the concessions made by it.

Section 1312 of the Revenue Act of 1924, authorizing the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to enter into an agreement finally settling the tax liability of a citizen, was not in effect when, in 1920, the tax here involved was adjusted. The only provision of the statute then in effect authorizing the compromise of taxes was Section 3229 of the Revised Statutes. The Government does not contend, nor does the Court's opinion in this case hold, that any officer of the Bureau of Internal Revenue had authority to enter into a binding contract with respect to the income-tax liability of the claimant in the case at bar.

The proposition that no officer or employee of the Bureau of Internal Revenue had authority to bind the Government by contract except as authorized by law is so well settled that it is unnecessary to refer to the pertinent statutes and the decisions of the courts.

As stated by the Court at page 11 of its opinion the Government contends that since the taxpayer "accepted the partial disallowance as to compensation, and also received certain concessions as to other disputed items, the benefit of which it still enjoys * * * plaintiff is estopped from recovery in this action.

That a taxpayer may be so estopped by his conduct in dealing with the representatives of the Government is abundantly settled by authority—

> *McDonald Coal Company* v. *Lewellyn*, 9 Fed. (2) 994; affirmed 16 Fed. (2) 274.
>
> *McDonald Coal Company* v. *Heiner*, 9 Fed. (2) 992.

In this *McDonald case* the Plaintiff did business as a corporation, and the stockholders also did business as a partnership under the same name. The corporation filed the tax returns for certain years and paid the taxes. Later it sought to recover these taxes claiming the taxes were due from the partnership. The court said:

> They ought not in honesty and good faith to be permitted to represent themselves to be a corporation, file corporate tax returns, file copies of minutes of corporate action, certify the sale and transfer of partnership property to the corporation, and then deny the incorporation when it suits the convenience of the incorporators. *McDonald Coal Company* v. *Heiner*, 9 Fed. (2) 992.

There is in this *McDonald case* no suggestion of contract or mutual agreement or anything of the kind, but it is an application of the general rule of equity and good conscience.

It is the general rule of law that where differences between parties have been adjusted by mutual concessions, the adjustment or settlement, which has been executed in accordance therewith, may not be opened up by a party without the restoration of the *status quo*.

It would be against equity and good conscience to allow the party to retain the concessions granted him and at the same time allow him to recover back the concessions he had given to the other party.

The Government may not assess additional taxes after five years after the return was due or filed. This five years would expire in the case in hand March 15, 1923. This action was begun September 12, 1924, so that the Government was at that time and is now barred from any recovery against the taxpayer on items for the year 1917.

Wherever a contract or settlement or arrangement, which is not conclusive or binding on the parties, is sought to be set aside, it is held that good faith, honesty, and fair dealing require the plaintiff, as a condition precedent, to restore the conditions to the *status quo.*

The books are full of these cases and this doctrine.

Grymes v. *Saunders,* 93 U. S. 55.

McLean v. *Clapp,* 141 U. S. 429.

Cook v. *Fidelity & Deposit Company,* 167 Fed. 95.

Hill v. *Northern Pacific Ry. Company,* 113 Fed. 914.

Walker v. *Alamo Food Company,* 16 Fed. (2) 694.

The complainant in this case seeks to ignore this universal principle of law, to hold to the benefits he has received and to recover back what he gave.

This court has rightly held that he may not do this, and the decision of this court is just and right.

Respectfully submitted,

HERMAN J. GALLOWAY,
Assistant Attorney General.

R. C. WILLIAMSON,
Attorney.

NOTE.—This brief has been prepared by A. W. Gregg, General Counsel, and Frederick W. Dewart, Special Attorney, Bureau of Internal Revenue.

SUPPLEMENTAL ARGUMENT

Supplemental to the argument in the Government briefs quoted, we beg to add the following:

The administration of the income tax laws is vested in the Treasury Department, and the administrative functions are vested in the Commissioner of Internal Revenue. His acts, within the scope of his authority, must be considered the official acts of the Secretary of the Treasury, and are binding on the Government.

Soule vs. United States, 100 U. S., 8;

Hamilton vs. Dillon, 21 Wall., 73;

Re Huttman, 70 Fed. Rep., 699;

Parish vs. United States, 100 U. S., 500.

The Commissioner of Internal Revenue had the power and it was his duty to examine the taxpayer's return, and for the purposes of taxation, investigate the facts, confer with the taxpayer and its representatives, hold hearings, and to exercise his judgment in reaching his conclusions as to the reasonable and proper amount of compensation for the services of directors allowable as ordinary and necessary expenses. This, the Commissioner did. We believe it material to this issue to bear in mind that all the questions involved in this settlement were of fact, the determination of which involved judgment and opinion, which it was within the scope of the authority and the duty of the Commissioner to exercise. They were not certain or fixed amounts which could be determined with mathematical certainty. There was room for wide differences of opinion and judgment of reasonable men as to what allowances would have been fair and reasonable. In the agreement of settlement and its return based

thereon and in accordance therewith, the taxpayer accepted and agreed to the amount of such compensation as determined and allowed by the Commissioner, in consideration of the determinations and allowances made by the Commissioner on the other items in dispute, which all involved like exercise of judgment and discretion in their determination, and which the taxpayer considered were determined and adjusted to his advantage. The general settlement covered all of these disputed items. It was performed by both the government and the taxpayer. The taxpayer paid the net additional tax assessed on account of the adjustments agreed upon, including the additional tax on account of the particular item regarding the allowable compensation to directors for services, to the determination of which by the Commissioner, the taxpayer had agreed. The case was closed. The statute of limitations ran against the Government as to all the other items in the settlement on March 15, 1923. This suit was begun by the taxpayer against the Government on September 14, 1924. There was no fraud, mistake of fact, error in mathematical calculation or new material evidence. By this suit, the taxpayer seeks to retain all the advantages he gained in the settlement and at the same time recover back what the Commissioner determined and what the taxpayer agreed in that settlement was due the Government on the particular item involved in this suit.

It is difficult for us to believe that the taxpayer, under these circumstances, should be permitted to repudiate and set aside a part of the executed agreement of settlement which it alleges was to its disadvantage, the benefits of which agreement as a whole, the taxpayer retains, and of which it cannot be divested. We see no equity or force in the contention that the Commissioner had no express statutory authority to enter into such agreement of settlement, therefore, the taxpayer is relieved from its binding

force, and may recover in this suit on one item while holding the benefits derived on the other items included in the general settlement.

We respectfully submit, however, that the Commissioner of Internal Revenue, possessed of the general authority required for the efficient administration of the revenue act, is not required to find express statutory authority for all his acts in order to establish their validity or binding force. An administrative officer charged with the administration of statutes cannot be required to find express statutory authority for every step in the exercise of his discretionary powers. This was long ago pointed out by this Court. In *United States vs. McDaniel*, 7 Pet. 1 (1833) at pages 13-14, this Court said:

> "A practical knowledge of the action of any one of the great departments of the government, must convince every person, that the head of a department, in the distribution of its duties and responsibilities is often compelled to exercise his discretion. He is limited in the exercise of his powers by the law; but it does not follow, that he must show statutory provision for everything he does. No government could be administered on such principles. To attempt to regulate, by law, the minute movements of every part of the complicated machinery of government, would evince a most unpardonable ignorance on the subject. Whilst the great outlines of its movements may be marked out, and limitations imposed on the exercise of its powers, there are numberless things which must be done, that can neither be anticipated nor defined, and which are essential to the proper action of the government."

The petitioner is asserting a pecuniary demand against the United States, and has brought suit for the recovery thereof against the Government in the Court of Claims.

We respectfully submit he should be held to the same degree of fair dealing and good faith which a long list of authorities require should characterize the sovereign in dealing with its citizens.

United States vs. Johnston, 124 U. S., 236;

United States vs. Philadelphia and Reading R. R. Co., 123 U. S., 113;

Utah Power & Light Co. vs. United States, 230 Fed., 328, 342;

United States vs. Williamette Valley and C. M. Wagon-Road Co., 54 Fed., 807, 811;

Walker vs. United States, 139 Fed., 409; 148 Fed., 1022;

State of Iowa vs. Carr, 191 Fed., 257;

United States vs. Stinson, 125 Fed., 907; 197 U. S., 200, 204;

Hemmer vs. United States, 204 Fed., 898;

Pan American Pet. Co., vs. United States, 9 Fed., 761;

United States vs. Midway Northern Oil Co., 232 Fed., 619;

State of Indiana vs. Milk, 11 Fed., 389;

United States vs. Hill, 120 U. S., 169, 182;

Western Union Tel. Co. vs. Julian, 169 Fed., 166, 175;

Scott County vs. Advance-Rumley Thrasher Co., 288 Fed., 739;

Bates & Guild Co. vs. Payne, 194 U. S., 106, 108-109;

Jackson vs. United States, 19 Ct. of Cl., 504;

Waddell vs. United States, 25 Ct. of Cl., 323;

Re Presbyterian Church, 9 Op. Atty. Gen., 100;

Dugan vs. United States, 34 Ct. of Cl., 458;

First Nat'l Bank of Greencastle vs. United States, 15 Ct. of Cl., 225;

United States vs. Kaufman, 96 U. S., 567, 570;

Penrose vs. Skinner, 278 Fed., 284, 286; 298 Fed. 335;

United States vs. Savings Bank, 104 U. S., 728;

Muser vs. Magone, 155 U. S., 240;

United States vs. Chandler-Dunbar Water Power Co., 152 Fed., 41, 81 C. C. A. 221.

In *United States vs. Johnston*, 124 U. S., 236, the accounts of a special agent of the Treasury Department designated to collect abandoned cotton in the southern states during and after the war were closed by the Department in a rather irregular manner, and subsequently the Government sought to reopen the accounts. The Supreme Court held this should not be done, saying (p. 254):

> "The utmost that the record establishes is that there were irregularities, perhaps carelessness, in the final closing of defendant's account with the Government. It may be that he should have been required to present more satisfactory evidence than it may be supposed from the record he did in fact present. These considerations, however, even if entitled to weight as matter of law, lose much force after the lapse of years without action upon them by the Government. The defendant ought not now to be held to the same strictness

of proof that might justly have been required of him when all the circumstances connected with the cotton in question could have been readily established by competent evidence. We are of opinion that no case is made by the Government to invalidate the settlement of defendant's accounts. We concur with the referee when he says that 'it would be an exceedingly dangerous doctrine that settled accounts where the United States had acted on the settlement and paid the balance found due on the basis of that settlement, could be opened or set aside, merely because some of the prescribed steps in the accounting which it was the duty of a head of a department to see had been taken, had been in fact omitted; or, if they could be so opened and set aside on account of technical irregularities in the allowance of expenses years afterwards, when the remedy of the party against the United States is barred by the statute of limitations, and the remedies of the United States on the other side are intact, owing to its not being subject to any act of limitation'."

In *United States vs. Midway-Northern Oil Co.*, 232 Fed., 619, 631, the Court said:

"Where the sovereign comes into a court of equity, asserting a pecuniary demand against a citizen, or to protect its proprietary interest, its claims appeal, generally speaking, to the conscience of the Chancellor with the same, but no greater or less, force than that of a private individual under like circumstances, and it is the duty of the court to withhold relief, except upon terms which do justice to the citizen or subject, as determined by the jurisprudence of the forum. *Sweet vs. U. S.*, 228 Fed., 421,—C. C. A.—, and authorities cited; *Walker vs. U. S.*, (C. C.) 139 Fed., 409; *U. S. vs. Detroit Lumber Co.*, 200 U. S., 321, 26 Sup. Ct. 282, 50 L. Ed. 499; *Hemmer vs. U. S.*, 204 Fed., 898, 123 C. C. A. 194; *Iowa vs. Carr*, 191 Fed., 257, 112, C. C. A. 447. For, as said by Mr. Justice Severens,

speaking for the court in *United States vs. Chandler-Dunbar Water Power Co.*, 152 Fed., 41, 81 C. C. A. 221:

> When it (the sovereign) 'sues in equity as a private suitor on a cause of action relating to its proprietary interests, it is held to be affected by those equities which are recognized as fundamental in controversies between private parties. And why should this not be so? It derogates from the dignity and character of the Government to suppose that, formed as it is to secure impartial justice between individuals, it may nevertheless, in the conduct of its own affairs, without regard to the principles it represents, perpetrate upon the citizens wrongs which it would promptly condemn if practised by one of them upon another.' "

In *United States vs. Hill*, 120 U. S., 169, 182, the Court said:

> "This principle has been applied as a wholesome one for the establishment and enforcement of justice in many cases in this court, not only between man and man, but between the Government and those who deal with it, and put faith in the action of its constitutional authorities, judicial, executive and administrative."

In *Western Union Tel. Co. vs. Julian*, 169 Fed., 166, 175, the Court said:

> "It is equally well settled that the department of the government which represents the sovereignty of the state or of the United States in dealing with any particular matter may, by its conduct, estop the state or the United States, as the case may be, from arbitrarily withdrawing the grant of a right, and disappointing the just expectations which its laws and conduct raised, to the prejudice of one who has relied and acted on its laws and

the acts of its officers, when such action of the state will forfeit his property, rip up completed transactions, or prevent the future exercise of rights which vest in and flow from the original transaction. *United States vs. Walker* (C. C.), 139 Fed., 412, and authorities there cited."

In *Walker vs. United States,* 139 Fed., 409, affirmed in 148 Fed., 1022 (C. C. App. 5th C.) the Court said (p. 413):

"The underlying principle of all the decisions is that, when the sovereign comes into court to assert a pecuniary demand against the citizen the court has authority, and is under duty, to withhold relief to the sovereign, except upon terms which do justice to the citizen or subject, as determined by the jurisprudence of the forum in like subject-matter between man and man. The acts or omissions of its officers, if they be authorized to bind the United States or to shape its course of conduct as to a particular transaction, and they have acted within the purview of their authority, may in a proper case work an estoppel against the Government. *Lindsay vs. Hawes,* 2 Black, 560, 17 L. Ed. 265; *Davis vs. Gray,* 16 Wall., 203, 21 L. Ed. 447; *U. S. vs. Bank of Metropolis,* 15 Pet., 392, 10 L. Ed. 774; *Sinking Fund Cases,* 99 U. S., 719, 25 L. Ed. 496; *U. S. vs. Barker,* 12 Wheat., 559, 6 L. Ed. 728; *Cooke vs. U. S.,* 91 U. S., 398, 23 L. Ed. 237; *Duval vs. U. S.,* 25 Ct. Cl. 60; *Hartson vs. U. S.,* 21 Ct. Cl. 456. The principle that the sovereign is bound by his own acts, and those of his lawfully authorized agents within the purview of their authority, is a wholesome one, and requires the courts to visit an estoppel upon the sovereign in a proper case, where he invokes judicial action. While the application of the doctrine is attended with difficulty under our institutions, where sovereignty of the United States does not reside in any one person or collection of persons, that

difficulty is no reason for rejecting the operation of the principle, if the facts of the particular case will admit of its application.

• • • Whenever an affirmative act is necessary on behalf of the United States to effect or enforce a pecuniary right against an individual, the officer or department whose duty it is to do that act represents the United States as to the matter, and it is bound by his action or nonaction. *United States vs. Barker*, 12 Wheat., 559 6 L. Ed. 728; *United States vs. Bank*, 15 Pet., 377, 10 L. Ed. 774."

It has been said many times by the Courts that the equitable claims of the United States appeal to the conscience of the Chancellor with the same but with no greater or less force than would those of an individual under like circumstances.

State of Iowa vs. Carr, 191 Fed., 257, (C. C. App. 8th C.);

United States vs. Stinson, 125 F., 907; affirmed in 197 U. S., 200, 204;

Hemmer vs. United States, 204 Fed., 898 (C. C. App. 8th C.);

Pan-American Pet. Co. vs. United States, 9 F. (2nd) 761 (C. C. App. 9th C.);

United States vs. Midway Northern Oil Co., 232 Fed., 619.

In the early case of *State vs. Milk*, 11 Fed., 389, the Court said:

"Resolute good faith should characterize the conduct of States in their dealings with individuals, and there is no reason, in morals or in law, that will exempt them from the doctrine of estoppel" (citing cases).

We respectfully submit that the government and citizen enter this Court under conditions which place them on an equal footing and that the petitioner should be held to the same degree of good faith and fair dealing which should characterize the government in dealing with its citizens.

CONCLUSION

We respectfully submit that the executed agreement of settlement is binding; that the petitioner is estopped to question the settlement; and that the judgment below should be affirmed.

Respectfully submitted,

ARTHUR J. LEVY,
CLARENCE E. WILSON.

April 30, 1926.